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RUEHRI/AMCONSUL RIO DE JANEIRO 6977
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RHEHNSC/NSC WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUCPDOG/USDOC WASHDC 2357
RUEHC/DEPT OF LABOR WASHDC

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STATE FOR WHA/BSC AND DRL/IL
STATE PASS USTR FOR SULLIVAN/LEZNY
NSC FOR CRONIN
TREASURY FOR OASIA, DAS LEE AND FPARODI
USDOC FOR 4332/ITA/MAC/WH/OLAC/SHUPKA
USDOC ALSO FOR 3134/USFCS/OIO/EOLSON/DDEVITO/DANDERSON
STATE PASS EXIMBANK
STATE PASS OPIC FOR DMORONESE, NRIVERA, CMERVENNE
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SUBJECT: PROSPECTS FOR LABOR REFORM AFTER BRAZILIAN ELECTIONS

REF: SAO PAULO 280

¶1. Summary: Labor expert Jose Pastore told Poloff he has advised opposition presidential candidate Geraldo Alckmin not to pursue comprehensive labor reform immediately upon taking office, should he win, but to begin with more modest and less controversial legislative proposals that would remove disincentives to hiring and bring more workers out of the informal sector. End Summary.

¶2. Jose Pastore, a retired professor who advises Sao Paulo Governor (and opposition presidential candidate) Geraldo Alckmin on labor-related issues, met March 23 with Poloff and Pol and Econ Assistants. Pastore indicated that labor reform would be a difficult issue to campaign on, since although it is popular in the business community, it is likely to alienate many voters who associate it with taking rights away from workers. Poloff noted that Alckmin's advisors had indicated that, if elected, he would pursue labor reform in his first month in office. Pastore confirmed this, but noted that due to the complexity of the task, it would have to be undertaken in stages.

¶3. Pastore began by reiterating that labor reform ("reforma trabalhista") and industrial relations reform ("reforma sindical" - see refTel) are two sides of the same coin and should be pursued in tandem. Since both reforms would require amending the Constitution, they would need a three-fifths vote in both houses of Congress, in two separate votes, to pass them. This is a daunting task for any president, especially since both reforms would challenge entrenched interests.

¶4. Accordingly, Pastore recommends that "President Alckmin" begin with a more modest reform which would appeal to legislators and bring some workers immediate tangible benefits. He proposes, for example, changes in the legislation governing the Length of Service Guaranty Fund (Fundo de Garantia por Tempo de Servico - FGTS). This is a sort of unemployment insurance program funded by payroll taxes. One peculiarity of Brazilian labor law is that many of the rules are identical for all companies regardless of size. All employers are

required to contribute 8 percent of their payroll every month to FGTS. When a company lays off a worker or fires an employee without cause, it must pay the employee 40 percent of the funds accumulated in his/her FGTS. Thus, it is extremely expensive to dismiss workers, especially long-term employees, with the result that many companies - especially small businesses - are reluctant to hire new employees, at least on the books. Instead, if they need personnel, they simply hire informally. Workers so employed have no benefits or protection.

¶5. Pastore recommends that the percentage of the employer's contribution to FGTS, and the percentage of the fund paid to the employee upon termination, be made negotiable between employers and employees, at least for small and medium-sized enterprises (SMEs). The rigid 8 percent and 40 percent figures across the board, he thinks, create too much of a disincentive to hiring and are driving more employment into the informal sector. Flexibility should have the reverse effect. He said he proposed the idea to officials of President Lula's Workers' Party (Partido dos Trabalhadores - PT) when Lula came into office, but they dismissed it, fearing that flexible contributions would create "second-class employees" who received reduced severance pay. It didn't seem to bother them, he commented wryly, that workers in the informal sector, who receive no severance pay, are more like "fifth class employees." If these workers could be formally hired, made legal, and given a "carteira" (the official document carried by all legal workers containing all information pertaining to their status), they could qualify for the generous benefits of Brazil's social security system, thus measurably improving their standard of living.

¶6. Comment: Professor Pastore's modest proposal appears to be a reasonable first step towards changing the rules of the game for employees of SMEs. Reforming Brazil's antiquated, rigid labor system

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and reducing labor costs overall will be much more difficult: as Pastore said, it will require more than mere political capital and political will. It will require packaging reforms in a way to alleviate legislators' fears that by supporting labor reform they would be alienating workers and signing their political obituaries. End Comment.

¶7. This cable was coordinated/cleared with Embassy Brasilia.

MCMULLEN